

Message Text

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ACTION EA-09

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03

INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02

CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 L-03 H-02 PA-01 PRS-01 INT-05 FEA-01 OES-03

/093 W

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R 170835Z SEP 75

FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC 0319

INFO AMCONSUL MEDAN

AMCONSUL SURABAYA

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E.O. 11652: N/A

TAGS: EIND ID

SUBJECT: RESTRUCTURING OF KRAKATAU STEEL PROJECT

REFS: (A) STATE 124207 AND PREVIOUS

(B) JAKARTA A-215, 20 SEPT 1973

1. SUMMARY: PRESS REPORTS INDICATE GOI REEXAMINATION OF P.T. KRAKATAU INTEGRATED STEEL PROJECT HAS RESULTED IN STATE ENTERPRISE'S BEING REDUCED IN SCOPE AND PLACED UNDER AT LEAST NOMINAL SUPERVISION OF DEPARTMENT OF INDUSTRY. FINANCIAL BURDEN CONSIDERABLY ATTENUATED, END SUMMARY.

2. AS DEPARTMENT AWARE, FINANCIAL REQUIREMENTS ASSOCIATED WITH KRAKATAU STEEL PROJECT ARE HEAVILY IMPLICATED IN LIQUIDITY CRISIS THAT EARLIER THIS YEAR OVERTOOK INDONESIAN STATE OIL ENTERPRISE PERTAMINA, WHICH HAD FURNISHED MUCH OF KRAKATAU'S FINANCIAL BACKING. IN MARCH PRESIDENT SUHARTO ORDERED OUTSIDE REEVALUATION OF THE KRAKATAU

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PROJECT, TO RECOMMEND WHICH OF PLANS ALREADY MADE TO

CARRY OUT AND WHICH TO CANCEL OR MODIFY. STUDY NOW COMPLETE, AND NEGOTIATIONS WITH EQUIPMENT SUPPLIERS HAVE REDEFINED PROJECT.

3. MINISTER OF STATE FOR ADMINISTRATIVE REFORM
DR. J.B. SUMARLIN (ALSO DEPUTY CHIEF STATE PLANNING AGENCY BAPPENAS), WHO CHAIRED PRESIDENT SUHARTO'S "KRAKATAU PROJECT REEVALUATION TEAM," GAVE A PRESS CONFERENCE ON 1 SEPTEMBER IN WHICH HE ANNOUNCED PRESIDENTIAL DECISION 30/1975 OFFICIALLY APPROVING THE CONTINUATION OF KRAKATAU STEEL PROJECT ON MODIFIED BASIS. WHAT FOLLOWS IS BASED ON RESULTANT PRESS ACCOUNTS, INTERPRETED WITH AID OF INFORMATION FROM VARIOUS SOURCES IN OUR FILES. BECAUSE OF KRAKATAU PRESIDENT-DIRECTOR'S FOREIGN TRAVEL, NO OPPORTUNITY AS YET TO OBTAIN DEFINITIVE CLARIFICATION AND DETAIL.

4. ORGANIZATION: SUMARLIN, ACCORDING TO THESE ACCOUNTS, RETAINS AUTHORITY OVER IMPLEMENTATION OF THE PRESIDENTIAL DECISION, ALTHOUGH STATE ENTERPRISE P.T. KRAKATAU IS FORMALLY UNDER OPERATING SUPERVISION OF DEPARTMENT OF INDUSTRY. PROCUREMENT CONTRACTS HAVE BEEN REWRITTEN TO SHOW KRAKATAU AS CONTRACTING PARTY RATHER THAN PERTAMINA AS BEFORE (OR RATHER, AS EMBASSY UNDERSTOOD, PERTAMINA PRESIDENT GENERAL IBNU SUTOWO IN SOMEWHAT AMBIGUOUS CAPACITY). AS DEPARTMENT AWARE, KAISER ENGINEERS/ARMCO ARE SERVING AS CONSULTANTS TO KRAKATAU. IT APPEARS THAT MOST, IF NOT ALL, SUPPLY AND CONSTRUCTION CONTRACTORS HAVE SURVIVED THE RENEGOTIATIONS ALTHOUGH IN SOME CASES WITH SMALLER ORDERS AND DIFFERENT TERMS.

5. FINANCIAL SAVINGS: NEGOTIATIONS WITH SUPPLIERS HAVE REDUCED KRAKATAU OUTLAY FROM \$2.3 BILLION ORIGINAL AND \$935 MILLION REVISED COSTS. DIFFERENCE APPARENTLY REPRESENTS LOCAL COSTS. OF \$953 MILLION REVISED FOREIGN-EXCHANGE CONTRACT COSTS \$455 MILLION HAVE ALREADY BEEN PAID, WHILE \$480 MILLION OBLIGATION REMAINS. KRAKATAU NEGOTIATORS REPORTEDLY WON AGREEMENT THAT RUPIAHS WOULD BE ACCEPTED FOR THE EQUIVALENT OF \$70 MILLION OF THE \$480 MILLION OUTSTANDING. IT APPEARS THAT AMOUNTS PERTAMINA LIMITED OFFICIAL USE

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FURNISHED TO DISCHARGE KRAKATAU-INCURRED OBLIGATIONS WILL NOW BE CREDITED AGAINST PERTAMINA'S OUTSTANDING TAX PASS-THROUGH OBLIGATIONS TO GOI. (COMMENT: AMOUNT MENTIONED AS KRAKATAU PROGRESS PAYMENTS ALREADY MADE APPROXIMATES WHAT WE UNDERSTOOD PERTAMINA TO HAVE CONTRIBUTED TO KRAKATAU THROUGH DECEMBER 1974; HOWEVER PERTAMINA SOURCES INDICATE RECEIVABLE FROM KRAKATAU WILL BE CONSIDERABLY GREATER WHEN PERTAMINA'S 1975 OUTLAY IS COUNTED. EMBASSY

DOES NOT HAVE INFORMATION AVAILABLE TO ACCOUNT FOR HIGHER
FIGURE.)

6. INFRASTRUCTURE: ADVANCED STAGE OF CONSTRUCTION
REPORTEDLY LED TO DECISION TO RETAIN IN ITS ENTIRETY ALL,
OR NEARLY ALL, INFRASTRUCTURE PREVIOUSLY CONTRACTED.
POWER FROM 5X80 MW SIEMENS STEAM TURBINE POWER PLANT

(US,PER EMBASSY RECORDS, 30 MW DIESEL STATION) EXCEEDS
RESTRUCTURED PROJECT REQUIREMENT AND SOME OF POWER WILL
BE AVAILABLE TO PUBLIC THROUGH GREATER JAKARTA GRID.
KLOCKNER'S PROGRAM (PER EMBASSY RECORDS, PORT CAPABLE
OF RECEIVING SHIPS OF 50,000 DWT, 10 KMS, RAILWAY LINE,
30 KMS, WATER SUPPLY PIPELINE WITH CONNECTIONS, AND
CONVEYOR SYSTEM FROM PORT TO WAREHOUSES) APPARENTLY
UNAFFECTED.

7. STEEL MILL PROPER: IT APPEARS FERROSTAAL ORDERS WITH
SWINDELL DRESSLER FOR FOUR DIRECT REDUCTION LINES STAND;
BUT OF CIRCA 2 MILLION TONS' OUTPUT OF SPONGE IRON
KRAKATAU WILL PROCESS ONLY 500,000 INTO STEEL FOR
DOMESTIC CONSUMPTION WHILE REMAINDER WILL BE SOLD TO OTHER
CONSUMERS.(OF THIS ABOUT 500,000 TONS WOULD INITIALLY
BE ABSORBED BY SMALL DOMESTIC MILLS, LEAVING ABOUT 1 MILLION
TONS FOR EXPORT.) THIS IMPLIES CONCESSION OF 1.5 MILLION
TONS ELECTRIC FURNACE AND CONCAST FACILITIES. PRESS
ENUMERATES PELLETIZING, SLAB, AND HOT STRIP MILLS AS ALSO
HAVING BEEN CANCELLED. NO MENTION THESE SOURCES OF
KRAKATAU-MARUBENI COLD REVERSING MILL, WHICH SO FAR AS
WE ARE AWARE NEVER GOT OFF THE GROUND.

8. TO BEST EMBASSY'S KNOWLEDGE PROJECT'S PRESENT CASH
FLOW ARISES FROM SMALL ELEMENTS OF OLD TRIKORA MILL, A
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SOVIET AID PROJECT, WHICH HAVE BEEN PUT INTO SERVICE;
WIRE-DRAWING (ASUTALIAN TECHNICAL ASSISTANCE), OXYGEN
PLANT, MACHINE SHOP, AND SPIRAL WELDED PEPEMILL (JOINT
VENTURE WITH HOOGOVENS OF NETHERLANDS AND
IPI OF PHILIPPINES). BY MID-1976 WE UNDERSTAND FORMER
RUSSIAN-SUPPLIED BAR AND SECTION MILL WILL BE PRODUCING
REBAR AND SMALL SHAPES. TARGET FOR ENTRY INTO PRODUCTION
OF DIRECT REDUCTION AND STEEL FACILITIES NOW ON ORDER IS
BEFORE END 1977.

9. EMBASSY BELIEVES MANAGEMENT PROBLEMS WILL INEVITABLY
BE MAJOR CONCERN NOW THAT REEVALUATION SCRAMBLE IS BEHIND.
GOI HAS OPTED TO HAVE STATE ENTERPRISE ITSELF RUN PROJECT,
WITH CONSULTANTS IN STRICTLY ADVISORY ROLE. ORGANIZATION
MUST BE BUILT FROM FRAGMENTS THAT HAVE BEEN FUNCTIONING IN

ILL-COORDINATED FASHION, SOME UNDER PERTAMINA, SOME IN
JOINT VENTURE, SOME IDENTIFIED AS KRAKATAU STEEL -- AND
MUST BE STRUCTURED TO DIRECT PROJECT'S FURTHER DEVELOPMENT
AS IT IS ONLY NOW BECOMING DEFINED. CLEARER IDEA OF
FUTURE MAY BECOME AVAILABLE AFTER SUBMISSION CONSULTANTS'
MASTER PLAN SIX MONTHS FROM NOW.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: INDUSTRIAL DEVELOPMENT, STEEL PLANTS
Control Number: n/a
Copy: SINGLE
Draft Date: 17 SEP 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: CunninFX
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975JAKART11492
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750322-0035
From: JAKARTA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750944/aaaabmyt.tel
Line Count: 176
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 75 STATE 124207
Review Action: RELEASED, APPROVED
Review Authority: CunninFX
Review Comment: n/a
Review Content Flags:
Review Date: 15 JUL 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <15 JUL 2003 by BoyleJA>; APPROVED <18 NOV 2003 by CunninFX>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: RESTRUCTURING OF KRAKATAU STEEL PROJECT
TAGS: EIND, ID
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006